SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

October Term, 1969

No. 465

EDWARD SERZYSKO,

Petitioner,

—v.—

THE CHASE MANHATTAN BANK,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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THE CHASE MANHATTAN BANK,

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, Edward Serzysko, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above entitled case on May 20th, 1969.

Citations to Opinions Below

By a per curiam decision (unreported at this date) which appears as "Appendix A" to the Petition, the Circuit Court of Appeals affirmed the Judgment of the District Court for the Southern District of New York. The opinion of the District Court thus affirmed appears as "Appendix B" to this Petition and is reported at 290 F.Supp. 74 (S.D.N.Y. 1968).

Jurisdiction

The judgment of the Circuit Court was entered on May 20th, 1969. The jurisdiction of this Court is invoked under 28 USCA §1254(1).

Questions Presented

1. Does the right of an Investor Borrower to recover damages resulting from a bank's violation of the margin requirement of Regulation U 12 C.F.R. 221 depend on his degree of sophistication in so far as margin rules are concerned, i.e., is the Congressional purpose in adopting margin requirement for stock speculators better served by limiting such a right of recovery to non-sophisticated investors?

2. Where a lender has made a contract in violation of the margin requirements of Regulation U is the contract completely void as regards lender's rights or may it continue to rely on certain provisions thereof to the disadvantage of the borrower?

Statutes and Regulations Involved

The following Statutes and Regulations are involved:

The Securities and Exchange Act of 1934, Title 15 USCA §78g, §78cc and §78ff; Regulation U, 12 C.F.R. 221, Sections 221.1(a), 221.3(a) and (b)(1). The pertinent portions of the foregoing Statutes and Regulations appear in "Appendix C" to this Petition.

Statement

The Petitioner seeks to recover damages sustained by reason of the Respondent having made loans to him for the purpose of purchasing and carrying registered secur-

ities in excess of the amount of credit permitted under Regulation U (12 C.F.R. 221). Regulation U establishes the percentage of the market price which a bank may loan for the purpose of purchasing or carrying securities registered on a National Exchange.

The District Court although it found that the Respondent had violated Regulation U and the Petitioner was entitled to bring a private cause of action for the violation nonetheless held Petitioner was barred from recovering his damages because of the combination of two elements (1) that he induced the granting of the loans by signing a false "Non Purpose Statement" (that he would not use the proceeds to purchase or carry registered securities), and (2) that he was a sophisticated investor who knew what would constitute violations of the Regulation. This despite the fact that the District Court found that if the Respondent had used the due diligence required of it by the Regulation, it would have discovered the real use to which Petitioner intended to put the loan proceeds.

The Circuit Court affirmed the District Court's judgment adopting its opinion as its own.

Facts

Edward S. Serzysko, the Petitioner, is a Polish immigrant who served as a steward in the Polish Merchant Marine until January of 1943 when he came to the United States (15A).* From 1943 until August of 1952, he served as a steward in the United States Merchant Marine (16A, Exhibit A). In September of 1952, he enrolled as a part time student in the New York Institute of Finance (16A). The New York Institute of Finance is a preparatory school

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* Figures in parenthesis refer to the Joint Appendix in the Circuit Court.

for registered representatives of the New York Stock Exchange (16A). In October of 1953, he was accepted as a registered representative for the New York Stock Exchange and obtained employment as a customer's man with the New York Stock Exchange firm of Cosgrove, Miller & Whitehead (17A). He was with that firm until March of 1958 when he started employment with the New York Stock Exchange firm of Hill, Darlington & Co. (20A). The Petitioner maintained a margin trading account with his employer. In September of 1958, the market value of Petitioner's margin portfolio was approximately $200,000 against which he had a debit balance of $100,000, thus maintaining an equity position of some 50% (20A, 21A).

In 1958, the Petitioner decided to transfer his margin account from his own brokerage firm to a bank (23A). In order to accomplish this, he asked his employer, Mr. Hill, to introduce him to a large bank to which he could move his account (23A). Mr. Hill introduced the Petitioner to Mr. Hardiman who was then the Assistant Vice President of The Chase Manhattan Bank in charge of the bank's branch office at 214 Broadway, New York City (353A, 354A).

On September 3rd, 1958, the Petitioner met Mr. Hardiman at his office at the bank as a result of an appointment made by Petitioner's employer, Mr. Hill (26A). At that meeting Petitioner showed Mr. Hardiman a copy of his "Position Statement" with Hill, Darlington & Co. (26A and Exhibit No. 1). That statement showed that he owned some 28 listed stocks having a market value of approximately $200,000 against which he owed approximately $100,000. At that meeting, the Petitioner told Mr. Hardiman that he would utilize any additional monies the bank might loan him against that collateral to invest in stocks (33A). Mr. Hardiman then invited Mr. Serzysko to have lunch with him and Mr. Hill on September 8th,

1958. At the luncheon meeting, the transfer of Petitioner's account from Hill, Darlington & Co. to the bank was discussed (34A). On the day following the luncheon meeting, September 9th, 1958, the Petitioner and Mr. Hardiman again met at Mr. Hardiman's office in order to work out the details of the transfer of the margin account from the brokerage house to the bank (35A).

Mr. Hardiman on his direct examination testified that he stated that the bank would only make a non-purpose loan (that is, a loan not within the scope of Regulation U) (316A). That it would loan up to 70% of the value of the collateral supplied by Mr. Serzysko and that Mr. Serzysko represented to him that he would not use the proceeds of the loan to buy securities (361A). Hardiman also disclaimed any knowledge that he was aware that Petitioner's account with Hill, Darlington & Co. was a margin account (403A). Hardiman, however, acknowledged that on September 9th, 1958, the day after the luncheon meeting, that he, in the presence of the Petitioner, dictated to his, Hardiman's secretary at the bank, two letters for Serzysko's signature. (Exhibit No. 2 and Exhibit No. 3, 405A). Exhibit No. 2 is a letter addressed to Hill, Darlington & Co. and reads as follows:

> "This is to confirm my verbal instructions to you to deliver to The Chase Manhattan Bank, 189 Broadway Branch, attention of Mr. Harold E. Hardiman, Assistant Vice President, all of the securities listed on the attached statement against payment of your debit balance which I understand is in the neighborhood of $100,500."

Exhibit No. 3 was a letter addressed to The Chase Manhattan Bank, attention Mr. Harold E. Hardiman, Assistant Vice President, and reads as follows:

"I have instructed Hill, Darlington & Co., 40 Wall Street, to deliver to your bank various securities a list of which is attached, valued in the neighborhood of $200,000. Upon delivery of these securities, please pay Hill, Darlington & Co., approximately $100,500 to the debit of my account."

The list of securities mentioned in each of those letters was the "Position Statement" of the plaintiff with Hill, Darlington & Co., dated July 31st, 1958, Exhibit No. 1. That Exhibit is headed "Margin—25—". There could therefore be no doubt that a margin account was being transferred from the brokerage firm to the bank and that Mr. Hardiman was clearly aware of it.

At that September 9th meeting, where the foregoing two letters were dictated by Mr. Hardiman and signed by Mr. Serzysko, Mr. Serzysko also signed in blank a checking account card (Exhibit No. 4), a Promissory Demand Note (Exhibit No. 5) and a so-called "Non Purpose Statement".

On September 12th 1958, after calculating the value of the collateral, the bank loaned Mr. Serzysko $150,000 against the securities which then had a market value of $203,704. $100,623.03 of that $150,000 was paid directly to Hill, Darlington & Co.

The balance of the $150,000 loan, $49,376.97, was deposited to Mr. Serzysko's newly opened checking account with the Bank (46A). The record reflects that the Petitioner used that money to purchase additional securities and caused these new securities to be transferred to the Bank as additional collateral for his loan (49A, 50A, 55A, 62A, 65A, 66A, 69A, 72A, 74A, 79A and 86A). The only checks withdrawn from that account during the years of its existence were either to pay interest to the Bank or to purchase additional registered securities (63A).

Subsequent to the loan of September 12th 1958, the Bank made the Petitioner several additional collateral loans. The dates and the amounts of which are as follows:

Date	*Amount*
October 27, 1958	$21,000.00
July 30, 1959	20,000.00
December 3, 1959	35,000.00
January 6, 1960	12,000.00
January 16, 1961	11,000.00
March 3, 1961	21,000.00

Each of the above loans were evidenced by Notes payable on demand (Exhibits 12, 16, 23, 27, 36, 41). In each of the above instances, the same procedure of signing the Note and the Purpose Statement was followed. From time to time, the Petitioner delivered to the Bank additional stock as collateral for the Petitioner's loans.

All of the collateral with two exceptions, consisted of stocks registered on a national exchange. The two exceptions were $13,000 Burroughs Corporation, 4½% Convertible Subordinate Debentures and $10,000 Vanadium Corporation of America, 4½% Convertible Subordinate Debentures, both sold shortly after their purchase and replaced by registered stock.

On October 2nd, 1961, the Bank changed the format of Petitioner's obligation from Demand Notes to a Time Note. Accordingly, on October 2nd, 1961, the Petitioner's obligations to the Bank were consolidated into a single Note for $270,000 payable in 90 days (382A). That Note was renewed on January 2nd, 1962, and again on April 3rd, 1962 (See Exhibits 52 and 53). In 1962, the stock market entered a period of decline. The Bank pressed the Petitioner to sell of the collateral against the loan some of

which the Petitioner, in fact, did. Finally, between June 5th and June 14th, 1962, with the market declining, the Bank, despite the fact that the Note did not mature until July 3, 1962, sold out all of the collateral in Petitioner's account which resulted in a $14,603.26 deficiency. (Exhibit C, 390A). This deficiency was reduced by a rebate of interest previously discounted in advance to $14,019.49 (Exhibit H).

During the entire period covered by the foregoing transactions, the maximum loan value, as set forth in Regulation U, was either 30% or 10%. As the chart below indicates, each of the Respondent's loans to the Petitioner was in excess of the maximum loan value and in violation of Regulation U if the purpose of the loan was either to purchase or to carry stocks listed on a national exchange.

Date	*Market Value of Collateral*	*Maximum Loan Value As Per Reg. U*	*Total Loan*	*Percentage of Loan to Collateral*	*Percentage of Plaintiff's Equity in Collateral*
9/12/58	$203,704	30%	$ 96,010	46%	27%

The above represents Hill, Darlington & Co. Margin Account.

9/12/58	203,704	30%	150,000	73%	27%
10/25/58	218,951	10%	171,000	78%	22%
7/30/59	274,289	10%	191,000	69%	31%
12/ 3/59	306,674	10%	226,000	73%	27%
1/ 6/60	345,501	10%	238,000	69%	31%
1/16/61	315,526	30%	249,000	79%	21%
3/ 3/61	356,228	30%	270,000	76%	24%
10/ 2/61	302,713	30%	270,000	89%	11%
1/ 2/62	351,227	30%	270,000	77%	23%
4/ 3/62	326,650	30%	270,000	83%	17%

The District Court found that the Respondent violated Regulation U in that it did not use the due diligence required by Section 221.3 of Regulation U which provides in part as follows:

"(a) In determining whether or not a loan is for the purpose specified in § 221.1 or for any of the purposes specified in § 221.2, a bank may rely upon a statement

with respect thereto only if such statement (1) is signed by the borrower; (2) is accepted in good faith and signed by an officer of the bank as having been so accepted in good faith and signed by an officer of the bank as having been so accepted; and (3) if it merely states what is not the purpose of the loan, is supported by a memorandum or notation of the lending officer describing the purpose of the loan. To accept the statement in good faith, the officer must be alert to the circumstances surrounding the loan and the borrower and must have no information which would put a prudent man upon inquiry and if investigated with reasonable diligence would lead to the discovery of the falsity of the statement."

Reasons for Granting the Writ

The holding of the Courts below, that the mere signing of a Non-Purpose Statement by an investor-borrower who is familiar with Regulation U is sufficient to bar his right to recover damages in a private suit for its violation, will frustrate the Congressional purpose by destroying the usefulness of private suits in this area as a supplement to the enforcement of the Securities and Exchange Act.

The Courts below acknowledged that a private cause of action for the violation of the margin requirements of the Securities and Exchange Act of 1934 is to be implied. They further acknowledged that private remedies are desirable in that they provide a necessary supplement to the enforcement of Regulations and Statutes. *J.I. Case Co.* v. *Borak* (1964) 377 U.S. 426.

However, Petitioner's right to recover was denied on the ground that his knowledge of Regulation U combined with his conduct was such that if he were permitted to recover, it would serve to encourage banking violations

of Regulation U rather than to deter them. We submit that this conclusion is unfounded.

Section 78g of 15 U.S.C.A. explicitly states that the margin requirements are fixed for the purpose of preventing the excessive use of credit for the purchase or carrying of securities.

The underlying theory of the statutory margin provisions is to reduce the aggregate amounts of the national credit resources which are directed by speculation into the stock market and to achieve a more balanced use of such resources in commerce, industry and agriculture. See House Committee Report No. 1383, 73rd Cong. 2nd Session. The text of this report reads in part as follows:

> "The main purpose of these margin provisions in section 8 is not to increase the safety of security loans for lenders. Banks and brokers normally require sufficient collateral to make themselves safe without the help of law. Nor is the main purpose even protection of the small speculator by making it impossible for him to spread himself too thinly—although such a result will be achieved as a byproduct of the main purpose.
>
> "The main purpose is to give a Government credit agency an effective method of reducing the aggregate amount of the nation's credit resources which can be directed by speculation into the stock market and out of other more desirable uses of commerce and industry. . . ."

The same thought was put in another way by Mr. Corcoran, one of the drafters of the statute in testimony before the Senate Committee on Banking and Currency. 73rd Cong. 1st Session PT. 15 at page 6494 where he testified:

> "One is to protect the lamb; another, and probably the more important of the two * * * is the protection of the national business system from the fluctuations that are induced by fluctuations in the market, which in turn stem back to this very exquisite liquidity you get when you have a lot of borrowed money in the market."

It thus appears that the dominant purpose of the Act was to protect the economic well-being of the country and the people at large and that a subsidiary purpose was to protect the margin speculator against his own imprudence. The legislative report on the then pending Security and Exchange Act from the House Committee on Interstate and Foreign Commerce H.R. Rep. No. 1383 73rd Cong. 2nd Session. 8(1934) stated:

> "Protection of the small speculator by making it impossible for him to spread himself too thinly will be achieved as a by-product of the main purpose."

Accordingly, it is submitted that this Petitioner's private right of action should be upheld on both theories. Obviously, he is a small speculator who lured by easy credit spread himself so thin that he was wiped out at the first substantial market break. Regardless of that fact, however, he and people like him, be they small speculators or large speculators, sophisticated or not sophisticated, should be encouraged to bring private actions since such actions will further the aim of the statute to restrict speculation and channel money into other more constructive facets of the economy.

The margin prohibitions of the Exchange Act are addressed to persons who "extend or maintain credit * * * for the purpose of purchasing or carrying any security registered on a national securities exchange * * * *" No duties

or restrictions are imposed upon the investor. Thus, in any transaction in which security credit is extended, the statute places the entire burden of observing the margin requirements on the lender, not the investor-borrower. An examination of Regulation U indicates clearly that the sanctions are imposed on the bank. The first sentence of the opening paragraph of Section 221.1(a) reads as follows:

"No bank shall make any loan secured * * *."

The reason why the sole burden of compliance is placed on the lending institution is obvious. That is the only place where the flow of funds may be cut off. To place a burden of compliance on the borrower would only inhibit enforcement of the Act, since it would discourage private suits which are the most effective means of obtaining compliance.

The lower Court in arriving at its decision to bar recovery on the part of the Petitioner says that to permit him or any sophisticated investor who had knowledge of the provisions of Regulation U to recover in a private action would be to encourage rather than discourage deception on the part of investor-borrowers with resulting prejudice to the observance of the margin requirements. It is submitted that this is an inaccurate observation, for to permit recovery by plaintiffs regardless of the extent of their knowledge of the law would put teeth in the good faith requirements of Regulation U. The banks would then be put on notice that they cannot deliberately close their eyes to the requirements of Regulation U and escape its enforcement by going through a ritualistic procedure of asking leading questions as to the proposed use of the funds being borrowed followed by the equivalent of a wink of the eye. If the lower Court's rationale were to stand, banks could loan money in violation of the Regulation with impunity as against civil actions simply by presenting the proposed borrower with a non-

purpose statement for his signature and a copy of Regulation U attached thereto.

Human nature being what it is, speculators will seek out all possible funds with which to speculate. The knowledge that they may eventually have a cause of action against a lender if they suffer losses will not increase their attempts to borrow. At the time the borrowing is made the speculator is motivated solely by the large profits that he foresees. However, if the Bank is made aware that it will bear any losses that the speculator may suffer if it fails to comply scrupulously with the good faith requirement of the Regulation, it will give more than lip service to the requirements of the Act. If the purpose of the Act is to be achieved, i.e., to prevent the infusion of large sums of money in the speculative market at the expense of more constructive elements of the economy, little is gained by confining deterrence to loans to non-sophisticated investors. All speculators must be frustrated in seeking an illegal source of funds with which to speculate. Thus, the dominant purpose of the Act will best be served by making as certain as possible that banks will neither lend to nor conspire with any investors, large or small sophisticated or not.

It may be true that in the eyes of some a borrower who after losing the monies he borrowed, sues the bank for his losses is committing a morally reprehensible act. That, however, does not bar his right to recover if his action furthers an overriding public policy. See *Perma Life Mufflers, Inc.* v. *International Parts Corporation,* 392 U.S. 134 (1968). In the *Perma Life Case,* the plaintiff, whom this Court permitted to recover in a civil antitrust suit, was itself guilty of violating the criminal laws. Nevertheless, this Court felt that overriding public policy required that he be permitted to recover treble damages. In the case at bar, the Petitioner violated no law. The

sole burden of compliance was on the defendant and it must be remembered that the primary emphasis in granting a private right of action under the reasoning of the Court in *J. I. Case* v. *Borak, supra,* is not upon compensation of the plaintiff but upon punishment of the defendant and deterrence of future violations.

Section 78cc, Subdivision (b) Title 15 U.S.C.A., provides that "Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder shall be void (1) as regards the rights of any person who, in violation of any such provision, rule or regulation, shall have made or engaged in the performance of any such contract * * *."

The courts below have interpreted that section by implication to mean that such contracts are somewhat less than void.

The Promissory Note dated April 2nd, 1962 (Exhibit No. 53) which by its terms did not become due until July 2nd, 1962 constituted a contract made in violation of the statute. Nonetheless the courts below sanctioned the Bank's reliance on those provisions of the Note which permitted it to sell plaintiff's collateral before the Note's due date. It is submitted that Congress by the use of the word void meant void for all purposes with regard to the Bank and not just some. The Bank should not have been permitted to rely on provisions in the Note favorable to it and sell out Petitioner's collateral until his obligation fell due under the terms of his contract.

CONCLUSION

For the foregoing reasons, Petitioner prays that a writ of certiorari be granted.

Respectfully submitted,

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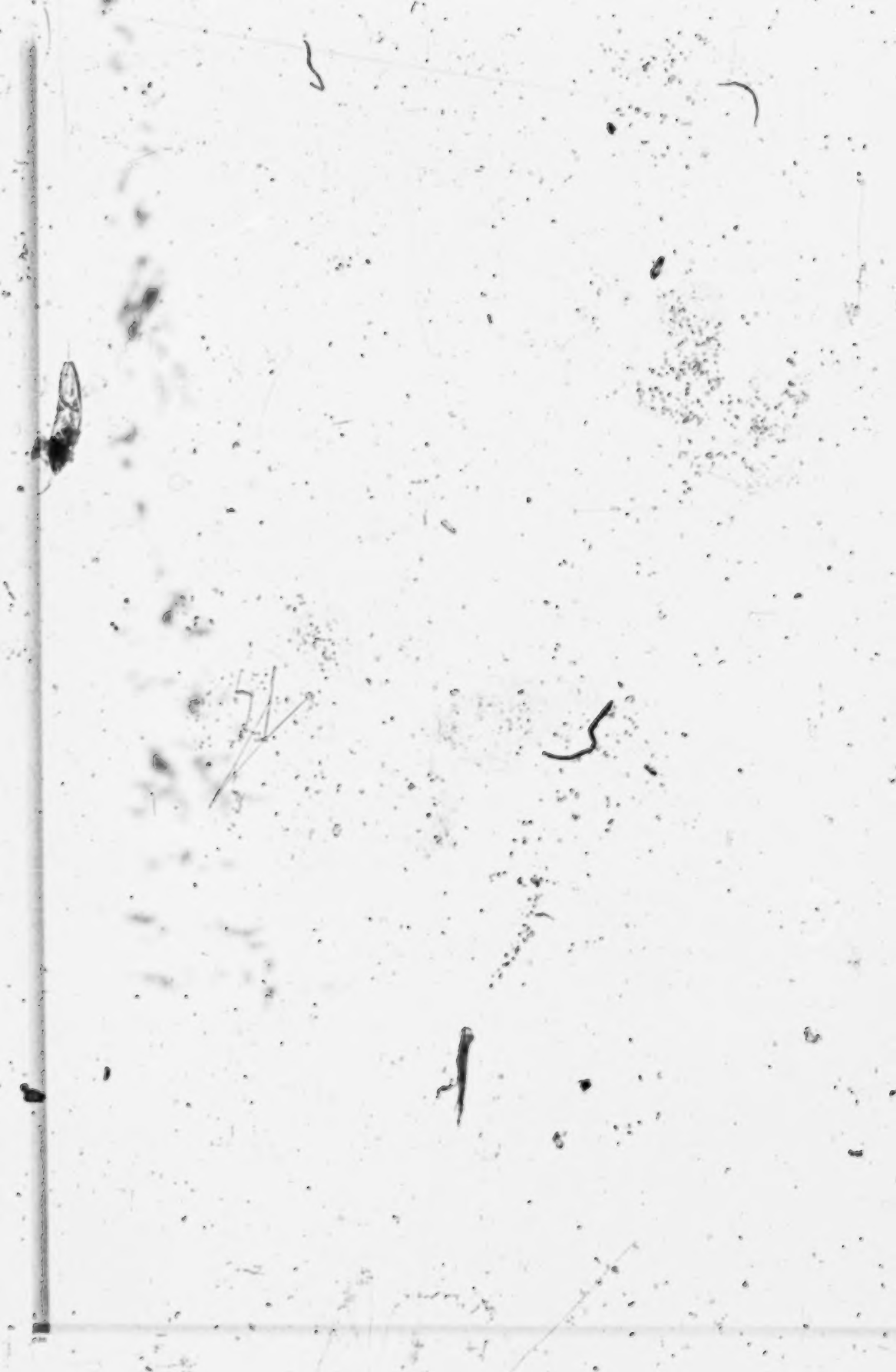

APPENDIX A

Per Curiam Decision of the Circuit Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 531 and 532—September Term, 1968.

(Argued April 22, 1969 Decided May 20, 1969.)

Docket Nos. 33096 and 33097

EDWARD SERZYSKO,

Plaintiff-Appellant-Appellee,

—v.—

THE CHASE MANHATTAN BANK,

Defendant-Respondent-Appellant.

Before:

LUMBARD, *Chief Judge,*

ANDERSON, *Circuit Judge,* and WYATT, *District Judge.**

Appeal, and cross-appeal, from a judgment of the District Court for the Southern District of New York, Graven, *J.*, dismissing plaintiff's complaint for damages sustained by reason of defendant having made loans to plaintiff in violation of Federal Reserve Board Regulation U, and dis-

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* Sitting by designation.

Per Curiam Decision of the Circuit Court of Appeals for the Second Circuit

missing defendant's counterclaim for the unpaid balance of the indebtedness incurred by plaintiff on the loans.

Affirmed.

ARTHUR C. FINK, New York, N. Y. (Fink, Weinberger & Levin and Walter Talmont, on the brief), *for plaintiff-appellant-appellee.*

A. DONALD MACKINNON, New York, N. Y. (Milbank, Tweed, Hadley & McCloy and Adlai S. Hardin, Jr., on the brief), *for defendant-respondent-appellant.*

PER CURIAM:

We affirm in all respects the judgment of the District Court for the Southern District of New York for the reasons stated in the thorough and well reasoned opinion of Judge Graven reported at 290 F. Supp. 74 (S. D. N. Y. 1968).

APPENDIX B

Opinion of the District Court

EDWARD SERZYSKO,

Plaintiff,

—v.—

THE CHASE MANHATTAN BANK,

Defendant.

No. 65 Civil 718

United States District Court
S. D. New York

Sept. 19, 1968

Jay J. Gurfein and Arthur M. Gurfein, of Gurfein & Gurfein, New York City, and Walter Talmont, Garden City, N. Y., for plaintiff.

A. Donald MacKinnon and Adlai S. Hardin, Jr., of Milbank, Tweed, Hadley & McCloy, New York City, for defendant.

MEMORANDUM

GRAVEN, Senior District Judge (by assignmnt).

1. The plaintiff is a citizen and resident of the State of New York. The defendant is a corporation engaged in the banking business in the City of New York, New York. The plaintiff seeks to recover damages allegedly caused to him by reason of loans made to him by the defendant, which loans he alleges were made in violation of Regulation U (12 C.F.R. 221) promulgated by the Board of Governors of the Federal Reserve System pursuant to Section 7(a) of the Securities Exchange Act of 1934, 15 U.S.C.A. Sec. 78g. That Regulation relates to the margin requirements

for loans made for the purpose of the purchasing or carrying of registered securities. Jurisdiction is based upon the Securities Exchange Act of 1934, 15 U.S.C.A. Sec. 78aa. The trial was to the Court.

Under the provisions of the Securities Exchange Act of 1934 and the regulations promulgated thereunder, issues of stock which are registered on a national securities exchange constitute registered securities. The New York Stock Exchange is a national securities exchange.

2. Commencing in September, 1958, the defendant made the plaintiff a number of loans. The loans were secured by collateral. The collateral in the main consisted of registered securities. In 1962, following a decline in the market value of the collateral, the defendant sold the collateral then remaining and applied the proceeds thereof on the then existing loan of the plaintiff. After applying the proceeds there was an unpaid balance on the loan of approximately $14,000.00. In this action the plaintiff seeks to recover the damages allegedly sustained by him by reason of the loans and such sale. The defendant by a counterclaim seeks to recover from the plaintiff the present unpaid balance of the loan.

3. Section 78g, Title 15 U.S.C.A., provides, in part, as follows:

> "(a) For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, prior to October 1, 1934, and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security

* * * registered on a national securities exchange. * * *
"* * *

"(c) It shall be unlawful for any member of a national securities exchange or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer—

"(1) On any security * * * registered on a national securities exchange, in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe under subsections (a) and (b) of this section.
"* * *

"(d) It shall be unlawful for any person not subject to subsection (c) of this section to extend or maintain credit or to arrange for the extension or maintenance of credit for the purpose of purchasing or carrying any security registered on a national securities exchange, in contravention of such rules and regulations as the Board of Governors of the Federal Reserve System shall prescribe to prevent the excessive use of credit for the purchasing or carrying of or trading in securities in circumvention of the other provisions of this section. * * *"

Paragraph (c) above set forth relates to brokers and dealers. Paragraph (d) above set forth relates to banker lenders.

Pursuant to the authority granted to the Board of Governors of the Federal Reserve System by the Securities Exchange Act of 1934, that Board promulgated Regula-

tions T and U. Regulation T governs the extension of credit to a customer by any member of a national exchange or any broker or dealer transacting business with a member. Regulation U covers loans by banks for the purpose of purchasing or carrying registered securities. Both prescribe minimum margin requirements referred to as maximum loan values which have been varied from time to time. It appears that the regulation places the entire burden of observing the margin requirements on the lender.

The Board of Governors of the Federal Reserve System is charged with the responsibility of promulgating regulations relating to margin requirements and the administration of them. The enforcement of the regulations of that Board has been assigned to the Securities and Exchange Commission. The Securities and Exchange Commission may bring an action to enjoin violators of the Act or to transmit evidence of violations to the Attorney General for the institution of criminal proceedings. Section 78u, Title 15 U.S.C.A.

Section 78ff, Title 15 U.S.C.A., provides, in part, as follows:

> "(a) Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter * * * shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both * * *; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation. * * *"

Section 78cc, Title 15 U.S.C.A., provides, in part, as follows:

"* * *

"(b) Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract * * * heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation * * *."

Section 221.1(a) of Regulation U provides, in part:

"No bank shall make any loan secured directly or indirectly by any stock for the purpose of purchasing or carrying any stock registered on a national securities exchange * * * in an amount exceeding the maximum loan value of the collateral, as prescribed from time to time for stocks in Section 221.4 * * *."

In Section 221.3(b) of the Regulation "carrying" is defined as encompassing a loan made "for the purchase of reducing or retiring indebtedness incurred to purchase that stock."

Section 221.3(a) of Regulation U provides:

> "(a) In determining whether or not a loan is for the purpose specified * * * a bank may rely upon a statement with respect thereto only if such statement (1) is signed by the borrower; (2) is accepted in good faith and signed by an officer of the bank as having been so accepted; and (3) if it merely states what is not the purpose of the loan, is supported by a memorandum or notation of the lending officer describing the purpose of the loan. To accept the statement in good faith, the officer must be alert to the circumstances surrounding the loan and the borrower and must have no information which would put a prudent man upon inquiry and if investigated with reasonable diligence would lead to the discovery of the falsity of the statement."

Section 78aa, Title 15 U.S.C.A., provides, in part, as follows:

> "The district courts of the United States * * * shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions of law brought to enforce any chapter or the rules and regulations thereunder. * * *"

[1] 4. The Securities Exchange Act contains no provision providing for a private cause of action for violation of the regulations promulgated by the Board of Governors of the Federal Reserve System relating to margin requirements. Private remedies are expressly provided in connection with violations of certain other sections of the Act.

Sections 78i(e), 78p(e), 78r(a), Title 15 U.S.C.A. There are a number of other sections as to which the Act has not provided any private remedies but as to which a private cause of action has been implied. J. I. Case Co. v. Borak (1964), 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423—(implied as to Section 14(a) of the Act Section 78n(a), Title 15 U.S.C.A.). See Notes, 77 Harvard L. Review 285 (1963-1964), 66 Columbia L. Review 1462 (1966). See, also, 61 Michigan L. Review 947 (1962-1963). The weight of authority is to the effect that a private cause of action is to be implied in the case of a violation of the margin regulations promulgated under the provisions of the Act. Smith v. Bear (2d Cir. 1956), 237 F.2d 79, 87-88, 60 A.L.R. 2d 1119; Remar v. Clayton Securities Corporation (D.C. Mass. 1949), 81 F.Supp. 1014; Appel v. Levine (S.D.N.Y. 1948), 85 F.Supp. 240; Warshow v. H. Hentz & Co. (S.D. N.Y. 1961), 199 F.Supp. 581; Glickman v. Schweickart & Co. (S.D.N.Y. 1965), 242 F.Supp. 670; Moscarelli v. Stamm (E.D.N.Y. July 12, 1968), 288 F.Supp. 453.

This Court holds that a private cause of action for violation of the margin requirements of the Act is to be implied. The troublesome and difficult questions involved in the present case and in certain other cases is as to the nature and character of the implied private cause of action. In all of the District Court cases above cited, the question as to the implied cause of action arose in connection either with motions to dismiss or for summary judgment and there was no evidentiary hearing on the merits. In the present case there was a complete and lengthy evidentiary hearing at which all of the facts relating to the transactions involved were fully developed.

5. The plaintiff was born in Poland in 1906. He served in the Polish Merchant Marine until 1943. From 1943 up

to September, 1952, he served in the United States Merchant Marine. From September, 1952, up until June, 1953, he attended the New York Finance Institute of the New York Stock Exchange. His courses in that Institute included courses on stock exchange transactions. From July, 1953, until October, 1953, he was a trainee with the stockbroker firm of Cosgrove, Miller & Whitehead. From October, 1953, until March 24, 1956, he was a registered representative of that firm and its successor. From March 23, 1960, until May 24, 1962, he was a registered representative of the stockbroker firm of Hill, Darlington & Company and its successor. From May 25, 1962 on, he was a registered representative of the stockbroker firm of Burnham & Company. All of the firms referred to were members of the New York Stock Exchange. As a registered representative of the broker firms referred to, the plaintiff handled the accounts of customers of the firms, including margin accounts.

During the periods of time here involved Harold Hardiman was the executive officer in charge of a branch of the defendant referred to as the Broadway Branch. George Hughes was also an officer of the same branch. During the forenoon of September 8, 1958, Thomas W. Hill, a member of the firm of Hill, Darlington & Company, talked with Mr. Hardiman. Mr. Hardiman had been acquainted with Mr. Hill for some time and regarded him as being highly reputable. Mr. Hill stated to Mr. Hardiman that Edward Serzysko, one of their registered representatives, was desirous of securing a loan from the Chase Manhattan Bank for the purpose of opening up a checking account. Mr. Hill further stated that he had a very high regard for Mr. Serzysko. Mr. Hardiman then brought up the matter of Regulation U. He informed Mr. Hill that the Bank

would not consider making a loan for use in purchasing or carrying registered securities within the scope of Regulation U. Loans not within the scope of Regulation U are referred to as nonpurpose loans. Mr. Hardiman, Mr. Hill and the plaintiff met for lunch on September 8, 1958, at which time the matter of the loan was discussed. The discussion covered the matter of Regulation U. All of them were familiar with that Regulation. Mr. Hardiman told the plaintiff and Mr. Hill that the Bank would only make a nonpurpose loan. The plaintiff represented to Mr. Hardiman that he desired the loan for the purpose of purchasing convertible bonds and other bonds. The purchase of bonds was not within the scope of Regulation U and a loan for such purpose would be a nonpurpose loan.

Pursuant to the discussion Hardiman prepared the papers for the proposed loan, which papers were dated September 12, 1958. On that date the plaintiff was the owner of registered securities having a market value of $203,704.00. They were pledged with a loan from the plaintiff from Hill, Darlington & Company in the approximate amount of $100,000.00. During the discussion on September 8, 1958, the matter of that loan was not referred to. On September 12, 1958, the Bank made the plaintiff a loan in the sum of $150,000.00 evidenced by a demand note. As security for the payment of the note the plaintiff pledged the shares of stock owned by him which, as heretofore noted, had a market value of around $200,000.00. On September 9, 1958. prior to the closing of the loan, the plaintiff in writing directed the Bank to pay Hill, Darlington & Company approximately $100,500.00 for debit to his account. Upon the delivery of the shares of stock the Bank paid Hill, Darlington & Company the sum of $100,623.03. At the time of the making of the loan the

plaintiff was orally informed by Mr. Hardiman that he would be expected to maintain a checking account equal to 10 percent of the loan.

6. In connection with the securing of the loan of September 12, 1958, the plaintiff executed a purpose statement. That statement was, in part, as follows:

"STATEMENT WITH RESPECT TO PURPOSE OF LOAN

Date SEP 12 1958

To THE CHASE MANHATTAN BANK,

189 Broadway Branch
(Head Office or Branch)

Pursuant to Regulation U promulgated by the Board of Governors of the Federal Reserve System, the following statement refers to a loan in the amount of $150,000.00, dated SEP 12 1958 due on demand, made by said bank to the undersigned.

A. The above described loan is not for the purpose
(is or is not)
of purchasing or carrying* stock registered on a national securities exchange.

/s/ Edward Serzysko
(Signature of Borrower or Bank Officer)
Edward Serzynsko [sic]

* * * * *

* Regulation U prescribes that no loan is for the purpose of carrying a stock registered on a national securities exchange unless the purpose of the loan is to enable the borrower to reduce or retire indebtedness which was originally incurred to purchase such stock.

The form of purpose statement was apparently one prescribed by the Board of Governors of the Federal Reserve System.

The Bank made the plaintiff several collateral loans. The dates and amounts are as follows:

Dates	Amounts
September 12, 1958	$150,000.00
October 27, 1958	21,000.00
July 30, 1959	20,000.00
December 3, 1959	35,000.00
January 6, 1960	12,000.00
January 16, 1961	11,000.00
March 3, 1961	21,000.00

All of the above loans were evidenced by notes payable on demand. On October 2, 1961, the plaintiff's indebtedness to the Bank on his demand notes was renewed by a note for $270,000.00 payable in ninety days. That note was renewed on January 2, 1962, and on April 3, 1962. The issues of stock pledged by the plaintiff for the $150,000.00 loan were twenty-seven in number. The plaintiff testified they were investments of a conservative nature. The market value of the collateral varied during the period of time in question. At the time of the making of the loan of September 12, 1958, the maximum loan value specified under Regulation U was 30 percent. At the time of the making of the other loans the maximum loan value specified under Regulation U was either 30 percent or 10 percent. The amount of the loans secured by the collateral on the average amounted to approximately 74 percent of the market value of the collateral.

7. The loans made by the defendant to the plaintiff following the loan of September 12, 1958, will next be referred to. On October 27, 1958, the Bank made the plaintiff a loan of $21,000.00 secured by the collateral then held by the Bank. In connection therewith the plaintiff executed a purpose statement similar to that executed in connection with the loan of $150,000.00. In that statement the plaintiff stated that the loan was not for the purpose of purchasing or carrying stock registered on a national securities exchange.

On May 4, 1959, the plaintiff wrote the Bank inquiring how much it would loan him against certain specified convertible bonds.

On July 30, 1959, the Bank made the plaintiff a loan of $20,000.00. The plaintiff stated that he wanted the loan for the purpose of purchasing convertible bonds. In connection with the loan the plaintiff executed a purpose statement. That statement was in different form from the two previous purpose statements. That statement was, in part, as follows:

"STATEMENT WITH RESPECT TO PURPOSE OF LOAN

Date JUL 30 1959

TO THE CHASE MANHATTAN BANK

Pursuant to Regulation U of the Board of Governors of the Federal Reserve System, the Statement indicated below is made in reference to a loan in the amount of $20,000.00, dated July 30, 1959, made by you to the undersigned.

* * * * *

[X] Statement II.

Said loan is not for the purpose of purchasing or carrying any stock registered on a national securities exchange * * * :

(Check (x) provision that is to apply)

* * * * *

[X] Other: Purchase of convertible bonds

(Fill Blank)

* * * * *

/s/ Edward Serzysko
Signature of Borrower"

On December 3, 1959, the Bank made the plaintiff a loan of $35,000.00. That loan was handled by George Hughes acting for the Bank. At the time the plaintiff stated to Mr. Hughes that he intended to purchase bonds with the loan. He signed a purpose statement similar to the one just above set forth. In it he stated that the loan was for the "Purchase of Bonds." As collateral security for the loan he deposited with the Bank $13,000.00 Burroughs Corporation 4½% Convertible Subordinated Debentures, some shares of stock he had secured as a dividend, and some shares of stock which he had purchased.

On January 6, 1960, the Bank made the plaintiff a loan of $12,000.00. He stated to Mr. Hardiman that he was going to use the loan to purchase convertible bonds or other bonds. Prior to the making of the loan the plaintiff deposited with the Bank collateral which consisted, in part, of $10,000.00 Vanadium Corporation of America 4¼% Convertible Subordinated Debentures. The plaintiff executed a purpose statement in which he stated that he was

going to use the loan "To purchase convertible or other bonds."

On January 16, 1961, the Bank made the plaintiff a loan of $11,000.00. He requested the loan for the purpose of paying taxes. In the purpose statement signed by him he stated that the loan was for "Taxes." The loan was secured by the collateral then held by the Bank.

On March 3, 1961, the Bank made the plaintiff a loan of $21,000.00. It was heretofore noted that the Bank had informed the plaintiff that he was expected to maintain a balance in his checking account equal to 10 percent of his loan. On March 3, 1961, the balance in his checking account was below that percentage. The loan was made for the purpose of maintaining such balance. In the purpose statement signed by him he stated that the loan was "To maintain balances." That loan was secured by the collateral the Bank then held.

On October 18, 1961, the plaintiff deposited $15,000.00 in United States Treasurey Notes as collateral. On May 21, 1962 he deposited $40,000.00 in those Notes as collateral. On June 18, 1962, he deposited $13,000.00 in those Notes as collateral.

8. Following the making of the original loan there were periods when the market value of the collateral substantially increased. There was also some increase in its value due to stock dividends on the stock held as collateral. There was also some increase in the value of the collateral due to the deposit of additional collateral and exchanges of collateral.

A decline in stock market values commenced in 1961 which continued into 1962, and the balance of the plaintiff's checking account went down below 10 percent. Com-

mencing in 1962 the Bank repeatedly urged the plaintiff to maintain a proper balance in his checking account and to reduce his indebtedness and furnish additional collateral. The plaintiff did not so do. From April 18, 1962, to June 7, 1962, after securing margin calls from the Bank, the plaintiff directed the sale of certain of the collateral and reduced the loan from $270,000.00 to $145,000.00. The market continued to decline and in May and June, 1962, the Bank sold the remaining collateral and applied the proceeds upon the plaintiff's loan. After the sale of the collateral there was a balance unpaid on the loan of $14,603.26. Subsequently some payments were made on the balance leaving a balance presently unpaid of $12,749.49 with interest for which the Bank asks judgment against the plaintiff.

Subsequent to the sale by the Bank of the shares of stock held by it as collateral in 1962, there was a steady appreciation in the market value of those shares. The plaintiff testified that as of January, 1958, the value of the shares sold by the Bank taking credit for stock splits and stock dividends had value of between $659,000.00 and $675,000.00.

On March 9, 1965, the plaintiff commenced the present action. In his complaint the plaintiff, after setting forth the loans made to him by the defendant, goes on to state:

> "16. That all loans were collateralized by securities registered on the New York Stock Exchange and American Stock Exchange which the plaintiff was carrying or had purchased out of borrowed funds which facts were known to the defendant or in the exercise of reasonable prudence should have been known to the defendant.

"17. That the defendant's conduct in making the loans and maintaining the loan account was in violation of the Securities and Exchange Act of 1934 and Regulation U promulgated by the Federal Reserve Board.

"18. That by reason of defendant's violation of the statute and Regulation as aforesaid, the plaintiff has been damaged in the sum of $268,031.00."

Prior to the trial the plaintiff moved to amend the ad damnum clause to ask "for the return of the securities sold by the defendant in May and June of 1962 or the present value thereof."

It is apparent from the proposed amendment that the plaintiff is of the view that there would be available in the stock market for acquisition by the defendant shares of stock which are the same as those sold by the defendant in 1962 and that the defendant should be required to replace them. That request is, in substance, asking for rescission of the loan transactions. In the event that return of the shares not be had, the plaintiff seeks to recover the damages allegedly caused to him by the sales of the stock in 1962.

The plaintiff as collateral for the original loan, pledged 27 issues of stock. Over 20 issues of that stock were still in the collateral in 1962. It was heretofore noted that the plaintiff testified that those issues constituted conservative investments. He further testified that he made use of the proceeds of the loans made to him by the defendant to purchase speculative issues.

The matter as to the amount of damages was by agreement of counsel deferred pending a determination of the issue as to liability.

The plaintiff testified that he used the available proceeds of the loans exclusively for the purpose of purchasing or

carrying registered securities. The plaintiff alleges that the defendant either knew or in the exercise of reasonable diligence should have known that he was using the proceeds of the loans for such purposes and hence the loans were in violation of Regulation U.

[2] 9. It is the contention of the plaintiff that where a lender makes a loan enabling the borrower to reduce or retire an indebtedness which was originally incurred for the purchase of registered securities such a loan constitutes a loan for the purpose of carrying registered securities in violation of Regulation U. It is the view of the Court that such is the proper interpretation of Regulation U. The plaintiff further contends that in the situation just above referred to the fact that the borrower has signed a purpose statement stating that the loan was not being obtained for the purpose of carrying registered securities does not absolve the lender from responsibility under Regulation U if the lender in the exercise of reasonable diligence would have ascertained that such was not the true situation. The plaintiff further contends that where a borrower is using the proceeds of loans to purchase and carry registered securities notwithstanding his having signed statements that the proceeds would not be so used, there is a violation of Regulation U if the lender could have discovered such misuse in the exercise of reasonable diligence.

10. The evidence preponderates that the plaintiff knowingly and intentionally, by oral and written statements, deceived the Bank as to the purposes for which he intended to use the proceeds of the loans. The evidence preponderates that none of the officers of the defendant having to do

with the loans had any actual knowledge of the falsity of the plaintiff's statements or his misuse of the proceeds of the loans. Where the proceeds of loans made by a bank are used by the borrower for the purpose of purchasing or carrying registered securities the fact the lender has no actual knowledge of such use does not completely answer the question as to whether Regulation U has been violated. Regulation U would be violated if the lender in the exercise of reasonable diligence should have known that the proceeds were being so used. Manifestly, if all that was required by a lender was to have the borrower execute a purpose statement and nothing more the object and purpose of that Regulation could be easily thwarted. The plaintiff contends that he was not a sophisticated investor. He testified that he was not familiar with the provisions of Regulation U. He also testified that several of the purpose statements were signed by him in blank and that the statements contained therein as to the use of the proceeds of the loans were afterwards incorrectly filled in by the defendant. The Court finds that the plaintiff was a sophisticated investor and was familiar with the provisions of Regulation U and that the statements contained in the purpose statements as to purposes of the loans were in accord with his representations.

The plaintiff calls attention to certain evidence which he asserts supports his claim that the defendant in the exercise of reasonable diligence should have discovered that the proceeds of the loan were being used by him for the purpose of purchasing or carrying registered securities. During negotiations for the original loan there was no discussion of the loan had by the plaintiff with Hill, Darlington and Company. However, later the plaintiff gave the Bank a written order to pay around $100,000.00 of

the proceeds of the loan to Hill, Darlington & Company to be debited to the plaintiff. When Hill, Darlington & Company delivered the securities held by that firm to the Bank, on a statement accompanying the delivery there appeared in typewriting the words "Margin—25." Mr. Hardiman testified that he did not observe those words on the statement and did not learn until after the last original loan was made in 1961 that the amount paid to Hill, Darlington & Company was in payment of a margin account loan of the plaintiff with that firm arising out of the purchase of registered securities.

The plaintiff also calls attention to the evidence which shows that on three occasions during the loan period the defendant made payments directly to Hill, Darlington & Company from the proceeds of loans to the plaintiff's credit against the delivery of registered securities to be added to the plaintiff's collateral. On November 17, 1960, the defendant paid Hill, Darlington & Company $26,009.95 against delivery of 525 shares of stock. On November 25, 1960, the defendant paid Hill, Darlington & Company $1,418.34 against the delivery of 100 shares of Avnet Electronics Corporation. On February 16, 1962, the defendant paid Hill, Darlington & Company $13,065.05 against the delivery of 300 shares of Thiokol Chemical Corporation.

Mr. Haridman testified that during the latter part of the loan period he began to be suspicious that the plaintiff was not using the proceeds of the loans in accord with his purpose statements. The defendant after January 3, 1961, made no further new loans to the plaintiff and in 1962 liquidated the collateral.

The question of reasonable diligence on the part of the defendant is troublesome. The plaintiff had been recom-

mended to the defendant as being highly reputable. The plaintiff both orally and in writing had repeatedly stated that the loans were not being used for the purpose of purchasing or carrying registered securities. The defendant's branch which handled the loans conducted a large business with a myriad of transactions involving the receipt and delivery of registered securities held as collateral. However, some of the plaintiff's activities, as shown by the defendant's records, were such as to indicate that he was not using the proceeds of the loans in accord with his oral and written representations. The situation was such as to indicate the need for investigation on the part of the defendant as to the use he had been and was making of the proceeds of the loans. Such investigation would have disclosed the fact that the plaintiff, contrary to his representations, had been using part of the proceeds of some of the loans for the purpose of purchasing or carrying registered securities. The Court is of the view that the defendant in the exercise of reasonable diligence would have discovered the falsity of the plaintiff's representations.

[3] 11. In the present case there was a violation of Regulation U by the defendant in connection with some of the loans due to its failure to exercise reasonable diligence. In the present case the plaintiff was a registered representative of a brokerage firm who was experienced and sophisticated in the matter of the investment of registered securities and the purchase of such securities on margin and familiar with the provisions of Regulation U. By false oral and written representations he induced and brought about the violation of Regulation U.

The defendant makes several contentions. It contends that the plaintiff is not within the class of those entitled to maintain an implied right of action for violation of the

margin requirements of the Securities Exchange Act of 1934 and Regulation U promulgated thereunder. The defendant also contends that the conduct of the plaintiff in connection with the loans was such as to bar any recovery on his part under the implied right of action. The defendant makes the further contention that the claims of the plaintiff based upon the first two loans are barred by the statute of limitations.

The first two contentions of the defendant will be next considered. Those contentions bring up for consideration the substantive features and the character of the private cause of action implied under the margin requirements of the Securities Exchange Act of 1934 and the regulations promulgated thereunder.

The early and landmark case in this area is the case of Remar v. Clayton Securities Corporation (D.C.Mass.1949), 81 F.Supp. 1014. In that case the plaintiff owned certain securities. He was advised by a broker to purchase other securities. The broker arranged with a bank to loan the plaintiff money to so do. The plaintiff pledged the securities owned by him and the securities purchased by means of the loan as collateral for the loan. Later the bank sold the collateral and there was a loan deficiency. The loan violated Regulation U. The plaintiff brought an action against the broker for the damages sustained by him for the loss of the securities. Recovery was sought under the provisions of Section 7(c) of the Securities Exchange Act of 1934 relating to margin requirements. The defendant moved to dismiss the complaint on the ground that the plaintiff did not have a remedy under that Act. The motion was overruled. The Court stated (p. 1017):

> "The Securities and Exchange Act does not expressly give a right or remedy to a private person in-

jured by § 7(c) of that Act. But such a right may nonetheless be implied. * * * The general principle regarding civil liability for violation of prohibitory statutes has been put with precision in Restatement, Torts, § 286 [1934]. Broadly stated, the rule is that where defendant's violation of a prohibitory statute has caused injury to plaintiff the latter has a right of action if one of the purposes of the enactment was to protect individual interests like the plaintiff's.

"That rule applies to the case at bar. Undoubtedly 'the main purpose' of § 7 of the Securities and Exchange Act was 'to give a government credit agency an effective method of reducing the aggregate amount of the nation's credit resources which can be directed by speculation into the stock market.' House Com. Rep. 73rd Cong., 2nd Sess. No. 1383. But Congress recognized that 'protection of the small speculator by making it impossible for him to spread himself too thin * * * will be achieved as a by-product of the main purpose.' Ibid. * * *

"Plaintiff's right of action is not affected by his participation as borrower in the transaction in which Clayton and the bank violated the statute. Since the statute was passed for the benefit of people like plaintiff, and since the Legislature regarded him as incapable of protecting himself, he is not disabled from suing for the injury he sustained. See Restatement, Torts, § 286 comment j * * *."

The Court goes on to state (p. 1017):

"In holding that a private person may have a right of action under § 7(c), I have not considered and do not decide whether this plaintiff has suffered damages

which are the proximate consequence of Clayton's violation. * * *"

Restatement of Torts, Sec. 286 (1934), referred to in the opinion, provides, in part:

"§ 286. VIOLATIONS CREATING CIVIL LIABILITY.

"The violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if:

"(a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and

"* * *

"(d) the violation is a legal cause of the invasion, and the other has not so conducted himself as to disable himself from maintaining an action."

In a hearing before the Senate Committee on Banking and Currency, 73d Congress, 1st Session, pt. 15, at page 6494, Mr. Corcoran, one of the drafters of the Exchange Act stated in regard to the matter of margin provisions:

"One is to protect the lamb; another, and probably the more important of the two * * * is the protection of the national business system from the fluctuations that are induced by fluctuations in the market, which in turn stem back to this very exquisite liquidity you get when you have a lot of borrowed money in the market."

At a hearing before a Senate Committee on the Securities Exchange Act of 1934, a representative of the Federal Reserve Board stated:

"We are less concerned about what happens to him [the large buyer], because he is very likely a person who knows the game, whereas when there are a thousand people buying on a small scale, they are buying it blind, and I think our interest, socially, is to protect them against the stock market." Hearings before Committee on Interstate and Foreign Commerce, 73d Congress, 2d Session 74 (1934).

In a Note, Federal Margin Requirements As A Basis For Civil Liability, 66 Columbia L. Review 1462, 1482-83 (1966), the author stated:

"* * * In the case of the knowing plaintiff-purchaser, however, the policy considerations are different. On the one hand, section 7 manifests an intention that the lender bear the entire burden of compliance with the margin requirements. On the other, the predominant purpose of the provision is to prevent 'the excessive use of credit for the purchase or carrying of securities.' Where the investor is a willful participant in a transaction violative of the margin regulations, these policies cannot be reconciled by allowing him to undo his contractual obligations whenever they prove unfavorable. Such license would serve as an incentive for margin traders to effect as many illegal transactions as possible. In this situation the two policies unavoidably conflict, and the policy against excessive security credit should prevail over the subsidiary intent to impose the burden of compliance upon the lender only. The sophisticated investor should therefore be deemed an accomplice to the defendant's violation and denied the right to rescind the contract under section 29 (b)."

In a Note in 61 Michigan L. Review 940 (1963), relating to private remedy for violation of margin requirements, the author stated (p. 954):

> "Perhaps the tort remedy should be available to an inexperienced trader in certain cases, but not to a sophisticated trader who knowingly assumes the risk of an inadequate margin. * * *
>
> "It seems likely that courts will continue to imply civil remedies for violations of credit regulations, at least for the protection of inexperienced margin traders. However, recovery should be denied to the sophisticated trader on the ground that he is an accomplice in the violation. Denying him a remedy would serve as a greater deterrent to future violations * * * than an allowance of relief. * * *"

12. It was heretofore noted that it was the contention of the defendant that the plaintiff, being a sophisticated trader, is not within the class of those who may bring an implied private action based upon violation of the margin requirements.

There is a distinction between the matter of a person being within the general class of those who may bring a private action based on a violation of a regulatory statute and the right of such person to prevail on the merits in such an action when brought. To attempt to define the classes of investor-borrowers who may bring an action for the violation of Regulation U in terms of the extent of their sophistication would present difficulty. In many cases the determination of the extent of the sophistication of the investor-borrower would require a preliminary evidentiary hearing. It would seem that one who comes within the classification

of an investor-borrower in connection with loans on registered securities may bring a private action for the damages allegedly sustained by him by reason of the violation of Regulation U subject to his being denied recovery on the merits. In connection with the merits the sophistication of a particular investor-borrower could, as in the present case, be of relevance in connection with the question as to whether his conduct should prevent recovery by him.

[4] It is the view of the Court that notwithstanding the fact the plaintiff was a sophisticated investor-borrower he is not for that reason prohibited from bringing this private action for the damages allegedly sustained by him by reason of violation of Regulation U. However, his sophistication enters into the situation in connection with the matter of his wrongful conduct, i. e., the procuring and inducing of loans by means of false representations. Because of his sophistication, he was familiar with Regulation U and knew what would constitute violations of it. Nevertheless, he knowingly and intentionally procured or induced the violations of which he now complains.

13. Where a plaintiff brings an action based upon a violation of a regulatory statute, there is frequently presented the question as to what effect is to be given to his own wrongful conduct in connection with the violation. That question would seem to be connected with the question as to the nature of the action. In the case of Goldenberg v. Bache and Company (5th Cir. 1959), 270 F.2d 675, there was involved in a private action by an investor against a broker the matter of the violation of Regulation T. In connection with the nature of the action the Court stated (p. 680):

"This action could be looked on either as an action *ex contractu*, based on the contract between stockbroker and customer as affected by the federal statute and regulations, or as an action *ex delicto*, based upon 'federal canon law torts.' * * * "

In the case of Warshow v. H. Hentz & Co. (S.D.N.Y. 1961), 199 F.Supp. 581, the plaintiff in his complaint alleged the making of a loan to him in violation of the margin requirements of the Act. The plaintiff sought either rescission or damages. The Court overruled a motion to dismiss the complaint. It stated (p. 582):

"Section 29(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78cc(b), provides that every contract which violates any provision of the Act or regulations thereunder is void and unenforceable by the party violating the Act, and the other party is entitled to rescission. * * * Further, the complaint supports a claim for damages sustained as the proximate consequence of defendant's act made illegal by Section 7(c) of the Act, 15 U.S.C.A. § 78g(c). * * * "

Under the case of Remar v. Clayton Securities Corporation, supra, and cases following that decision, it appears that an action by an investor against a lender based upon a violation of Regulation U is regarded as an action in tort under the rules stated in Section 286, Restatement of Torts (1934). Treating the action as a tort action gives rise to a number of troublesome questions as to the application of well-recognized tort rules relating to contributory negligence and other conduct of the plaintiff and causation and damages.

In all situations relating to violations of Regulation U, there is always present the feature of the investor having

executed the note for the loan involved. Therefore, he is in a sense a participant in the making of the illegal loan. However, it was noted in the case of Remar v. Clayton Securities Corporation, supra, that the Court held that the plaintiff's right of action was not barred by his participation in the making of the illegal loan. It would seem that the mere fact that the investor participated in the making of a loan which violated Regulation U does not per se bar him from relief.

Under Section 286 of the Restatement heretofore set out and which has, in general, been regarded as applicable to actions brought for violation of the margin requirements of the Securities Exchange Act of 1934, it is stated the violator of a legislative enactment, subject to certain requirements, is liable for damages legally caused to another. One of those requirements is that the complaining party "has not so conducted himself as to disable himself from maintaining an action." However, there are certain decisions of the United States Supreme Court that have to be considered in connection with the last portion of the Restatement Rule just referred to.

In the case of J. I. Case Co. v. Borak, (1964), 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423, the plaintiff brought a private action based upon a claimed violation by the defendant of Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C.A. 78n(a). The Act did not expressly provide for a private action for a violation of that Section. The Court held that a private cause of action would be implied not only for the protection of investors but also to provide a necessary supplement to the Securities and Exchange Commission's enforcement of the provisions of the Act. In that connection it mentioned that the statutory treble damage action provided for in civil antitrust actions served as an

effective weapon in the enforcement of the civil antitrust statute. The matter of the wrongful conduct of a plaintiff in connection with the matter of the recovery of damages allegedly sustained by him by violation of a regulatory statute was recently considered by the United States Supreme Court in the case of Perma Life Mufflers, Inc. v. International Parts Corporation (June 10, 1968), 392 U.S. 134, 88 S.Ct. 1981, 20 L.Ed.2d 982. In that action the plaintiffs sought to recover statutory treble damages from the defendants under the provisions of 15 U.S.C.A. Sec. 15 for violation of the civil antitrust laws. The claimed violation occurred in connection with franchise arrangements. The defendants made a motion for summary judgment based upon a showing that the plaintiffs had participated in the franchising arrangements. The motion was sustained by the trial court. That ruling was affirmed by the Seventh Circuit Court of Appeals (376 F.2d 692). On appeal the Supreme Court reversed. It stated (p. 135 of 392 U.S., p. 1982 of 88 S.Ct.):

> "The principal question presented is whether the plaintiffs in this private antitrust action were barred from recovery by a doctrine known by the Latin phrase *in pari delicto*, which literally means 'of equal fault.' * * *"

The Court further stated (pp. 138-139 of 392 U.S. p. 1984 of 88 S.Ct.):

> "* * * There is nothing in the language of the antitrust acts which indicates that Congress wanted to make the common-law *pari delicto* doctrine a defense to treble-damage actions, and the facts of this case suggest no basis for applying such a doctrine even if it did exist. Although *in pari delicto* literally means 'of

equal fault,' the doctrine has been applied, correctly or incorrectly, in a wide variety of situations in which a plaintiff seeking damages or equitable relief is himself involved in some of the same sort of wrongdoing. We have often indicated the inappropriateness of invoking broad common-law barriers to relief where a private suit serves important public purposes. * * * The plaintiff who reaps the reward of treble damages may be no less morally reprehensible than the defendant, but the law encourages his suit to further the overriding public gard for the relative moral worth of the parties would only result in seriously undermining the usefulness of the private action as a bulwark of antitrust enforcement. And permitting the plaintiff to recover a windfall gain does not encourage continued violations by those in his position since they remain fully subject to civil and criminal penalties for their own illegal conduct. * * *"

[5] Thus it appears that the rules stated in Section 286 of the Restatement in regard to a private cause of action for violation of legislative enactments must be considered in the light of the Supreme Court cases just referred to. Under the doctrine of those cases a private cause of action for violation of a regulatory statute must be considered in the light of the enforcement of such a statute.

It is to be noted that in the case of Perma Life Mufflers, Inc. v. International Parts Corporation, supra, the action for treble damages was based upon an express statutory provision. That is not the situation in the present case. It is also to be noted that in that case the Court noted that

the plaintiffs as participating wrongdoers would themselves be subject to statutory civil and criminal penalties. That is not the situation in the present case. It is also to be noted that in that case it appeared that the defendants actively and knowingly participated in the claimed violations. That is not the situation in the present case.

[6] 14. The purpose statement to be signed by an investor-borrower in connection with the securing of a loan is of importance in carrying out the object and purpose of the margin requirement regulations. The knowing and intentional making of a false statement by an investor-borrower in a purpose statement is fraught with prejudice to the enforcement of such regulations. If an investor-borrower could by means of false representations and statements mislead a lender into making a loan for the purchasing or carrying of registered securities when the lender did not know or intend that the loan would be used for such purpose, and then recover heavy damages from the lender on the basis that the lender in the exercise of reasonable diligence should have discovered the deceit, there would be encouragement for an investor-borrower to engage in the practice which, in substance, would be that so far as the investor-borrower is concerned he could keep the profits if his speculation proved profitable and have the lender bear the loss if the speculation proved unprofitable.

[7] 15. In some of the cases referred to reference is made to the doctrine of *in pari delicto* which is said to literally mean "of equal fault." The term *in pari delicto* has been applied to a variety of situations. It is the view of the Court that whatever the scope that doctrine may be it can hardly be said that one who is deceived by false rep-

resentations of another can be said to be *in part delicto* with him because of the fact that the deception might have been discovered in the exercise of reasonable diligence. It is clear from the decisions that in connection with an implied private cause of action for violation of a regulatory statute there must be taken into consideration the matter of supplementing the enforcement of the statute. The enforcement of such a statute is supplemented when the rules applied in private actions having to do with its violation are such as to tend to encourge the observance of the statute and to deter nonobservance of it. It is the view of the Court that to allow the plaintiff to recover in this action would be to encourage rather than discourage deception on the part of investor-borrowers with resulting prejudice to the observance of the margin requirements of the Act. In the case of Moscarelli v. Stamm, supra, the Court was of the view that to permit an investor-borrower who had wilfully participated in the violation of a margin requirement to recover damages for such violation would defeat the purpose of such requirement. The law tends to look with a jaundiced eye upon the claim of a deceiver that his victim should not have been deceived. However, in the case of the margin requirements here involved there is again involved the matter of the enforcement of a regulatory statute. Under the requirements of the margin regulations here involved, a lender in making a loan may not safely ignore the possibility of deceit on the part of the investor-borrower as to the use of the proceeds of the loan and to that end is required to exercise reasonable diligence under the circumstances in connection with the matter of the probable misuse of the proceeds of the loan on the part of the investor-borrower.

Some of the occurrences in connection with and following the arrangements for the loans were such as to indicate the reasonable likelihood that the plaintiff was using the proceeds of the loans for the purchasing or carrying of registered securities. If an investigation had been made it would have revealed that the plaintiff, contrary to his oral and written statements, was making use of the proceeds of some of the loans to purchase or carry registered securities. It is the view of the Court that the defendant should have made such an investigation and that in not doing so the defendant failed to exercise reasonable diligence.

[8, 9] 16. It was heretofore noted that the defendant by counterclaim seeks to recover the unpaid balance of the last loan made which is in the approximate sum of $12,000.00. Under the provisions of Section 221.3(a) of Regulation U heretofore set out, a lender is chargeable with exercising reasonable diligence in the matter of inquiring and investigating as to possible misconduct of the borrower in connection with the loan and the failure of the lender to exercise such diligence makes the loan a violation of Regulation U. Under the provisions of 15 U.S.C.A. Sec. 77cc(b) heretofore set out, contracts which are in violation of Regulation U are declared void.

It is the view of the Court that the note upon which the defendant seeks to recover comes within the scope of that Section.

17. It is the view of the Court that the plaintiff, by reason of his conduct, should be denied the relief requested by him. Such denial renders it unnecessary for the Court to pass upon the partial defense of the defendant based on the statute of limitations.

18. It is the view of the Court that the defendant, by reason of its failure to exercise reasonable diligence, should be denied the relief requested by it.

CONCLUSIONS OF LAW

1. This Court has jurisdiction of the subject matter of this action and the parties to the action.

2. The plaintiff is not justly entitled to the relief requested by him.

3. The defendant is not justly entitled to the relief requested by it.

APPENDIX C

Pertinent Statutes and Regulations

Pertinent Statutes and Regulations

The following Statutes and Regulations are involved:

The Securities and Exchange Act of 1934, Title 15 U.S.C.A. Sections 78g, 78cc and 78ff;

Regulation U, 12 CFR 221, Sections 221.1(a), 221.3(a) and (b)(1).

Section 78g, Title 15 U.S.C.A. provides in part as follows:

"(a) For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, prior to October 1, 1934, and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security * * * registered on a national securities exchange. * * *

"* * * *

"(c) It shall be unlawful for any member of a national securities exchange or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer—

"(1) On any security * * * registered on a national securities exchange, in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe under subsections (a) and (b) of this section.

"* * * *

"(d)" It shall be unlawful for any person not subject to subsection (c) of this section to extend or maintain credit or to arrange for the extension or maintenance of credit for the purpose of purchasing or carrying any security registered on a national securities exchange, in contravention of such rules and regulations as the Board of Governors of the Federal Reserve System shall prescribe to prevent the excessive use of credit for the purchasing or carrying of or trading in securities in circumvention of the other provisions of this section. * * *"

Section 78cc, Title 15 U.S.C.A. provides, in part, as follows:

"* * *

"(b) Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract * * * heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation* * *."

Pertinent Statutes and Regulations

Section 78ff, Title 15 U.S.C.A. provides, in part, as follows:

> "(a) Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter * * * shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both * * * ; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation. * * * "

Section 221.1 of Regulation U, provides, in part, as follows:

> "(a) No bank shall make any loan secured directly or indirectly by any stock for the purpose of purchasing or carrying any stock registered on a national securities exchange (and no bank shall make any loan described in § 221.3(q) regardless of whether or not such loan is secured by any stock) in an amount exceeding the maximum loan value of the collateral, as prescribed from time to time for stocks in § 221.4 (the Supplement to Regulation U) and as determined by the bank in good faith for any collateral other than stocks.
>
> "(b) For the purpose of this part, the entire indebtedness of any borrower to any bank incurred at any time for the purpose of purchasing or carrying stocks registered on a national securities exchange shall be considered a single loan; and all the collateral secur-

ing such indebtedness shall be considered in determining whether or not the loan complies with this part."

Section 221.3 of Regulation U, provides, in part, as follows:

"(a) In determining whether or not a loan is for the purpose specified in § 221.1 or for any of the purposes specified in § 221.2, a bank may rely upon a statement with respect thereto only if such statement (1) is signed by the borrower; (2) is accepted in good faith and signed by an officer of the bank as having been so accepted in good faith and signed by an officer of the bank as having been so accepted; and (3) if it merely states what is not the purpose of the loan, is supported by a memorandum or notation of the lending officer describing the purpose of the loan. To accept the statement in good faith, the officer must be alert to the circumstances surrounding the loan and the borrower and must have no information which would put a prudent man upon inquiry and if investigated with reasonable diligence would lead to the discovery of the falsity of the statement.

"(b) (1) No loan, however it may be secured, need be treated as a loan for the purpose of 'carrying' a stock registered on a national securities exchange unless the loan is as described in subparagraph (2) of this paragraph or the purpose of the loan is to enable the borrower to reduce or retire indebtedness which was originally incurred to purchase such a stock, or, if he be a broker or a dealer, to carry such stocks for customers."

APPENDIX D

Judgment of the Circuit Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the twentieth day of May one thousand nine hundred and sixty-nine.

Present:

HON. J. EDWARD LUMBARD,
Chief Judge,

HON. ROBERT P. ANDERSON,
Circuit Judge,

HON. INZER B. WYATT,
District Judge.

EDWARD SERZYSKO,
Plaintiff-Appellant,

v.

THE CHASE MANHATTAN BANK,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

Judgment of the Circuit Court of Appeals for the Second Circuit

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed.

A. DANIEL FUSARO
Clerk

SUPREME COURT, U. S.

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Supreme Court of the United States

October Term, 1969

No. 465

EDWARD SERZYSKO,

Petitioner,

v.

THE CHASE MANHATTAN BANK,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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Opinions Below

The District Court's opinion is reported at 290 F.Supp. 74. The Court of Appeals' *per curiam* affirmance is reported at 409 F.2d 1360. Because of errors and omissions in Appendix B of the petition, we refer this Court to the District Court's opinion as reported at 290 F.Supp. 74.

The Issue

May an experienced professional actively engaged in advising customers in the purchase and sale of securities, who procures bank loans by fraudulent misrepresentations and misuses the proceeds in violation of the margin regulations, undo his contractual obligations with the bank making the loans when his speculation proves unprofitable?

Statement

Petitioner, an accredited registered representative of the New York Stock Exchange employed by a member firm, sued respondent to recover as damages monies lost by him in speculating in securities with the proceeds of loans aggregating $270,000. The loans were claimed to have been made in violation of section 7 of the Securities and Exchange Act of 1934 and Regulation U of the Federal margin regulations because, contrary to his written and oral representations, he used the loan proceeds to purchase registered stocks. Respondent counterclaimed to recover the unpaid balance of petitioner's indebtedness.

The case was tried before Senior Judge Henry W. Graven, without a jury. After due consideration and a detailed analysis of the facts, the Court dismissed the complaint on the ground that recovery would be contrary to the purpose of section 7 and the margin regulations, and the counterclaim on the ground that even though respondent had no knowledge of petitioner's fraud, it failed to exercise proper diligence.

Both petitioner and respondent appealed and the Court of Appeals unanimously affirmed in a *per curiam* opinion.

The Facts

The decisions below were based on particular facts relating only to this case. The facts were set forth at considerable length in what the Court of Appeals stated was "the thorough and well reasoned opinion of Judge Graven."

Since 1953, petitioner has been an accredited registered representative of the New York Stock Exchange employed by various member firms to render professional advice and services to customers in the purchase and sale of securities.

As a registered representative he handled the accounts of customers, including margin accounts.

When petitioner first approached respondent, he represented that any loans he might make from respondent would be only non-purpose loans (*i.e.*, loans not within the scope of Regulation U). Thereafter, and before making a loan, petitioner executed and signed a "STATEMENT WITH RESPECT TO PURPOSE OF LOAN" in which he represented in writing that his purpose in making the loan was other than the purchase of registered stocks.

In the Fall of 1961 and early 1962, petitioner was urged by respondent to reduce his indebtedness or furnish additional collateral. After receiving margin calls from respondent in April and May 1962, petitioner directed the sale of certain of his collateral and reduced the amount of his loans from $270,000 to $145,000. In May and June 1962, when petitioner failed to meet further margin calls, respondent sold the remaining collateral and applied the proceeds to petitioner's indebtedness. This left an unpaid balance of $14,603.26, subsequently reduced by petitioner to $12,749.49, for which respondent counterclaimed.

The Trial Court found that "The evidence preponderates that the plaintiff knowingly and intentionally, by oral and written statements, deceived the Bank as to the purposes for which he intended to use the proceeds of the loans" (290 F.Supp. at 83), that "he was familiar with Regulation U and knew what would constitute violations of it" (290 F.Supp. at 87) and, further, that "The evidence preponderates that none of the officers of the defendant having to do with the loans had any actual knowledge of the falsity of the plaintiff's statements or his misuse of the proceeds of the loans" (290 F.Supp. at 83).

REASONS FOR DENYING THE WRIT

I

The District Court correctly ruled that to reward petitioner under the circumstances here present would subvert the policy and purpose of the margin regulations.

The Trial Court concluded that petitioner should be denied relief on the ground that recovery would be contrary to the very purpose of section 7 and the margin regulations. It said:

> "If an investor-borrower could by means of false representations and statements mislead a lender into making a loan for the purchasing or carrying of registered securities . . . there would be encouragement for an investor-borrower to engage in the practice which, in substance, would be that so far as the investor-borrower is concerned he could keep the profits if his speculation proved profitable and have the lender bear the loss if the speculation proved unprofitable." (290 F.Supp. at 89)

and

> "It is the view of the Court that to allow the plaintiff to recover in this action would be to encourage rather than discourage deception on the part of investor-borrowers with resulting prejudice to the observance of the margin requirements of the Act." (290 F.Supp. at 89-90)

The District Court's conclusion that the objective of the margin regulations would be subverted by conferring a reward upon professionals in the securities business who knowingly violate and induce violations of the statute is supported by the commentators. 61 Mich.L.Rev. 940, 954 (1963). To the same effect, see *Federal Margin Requirements as a Basis for Civil Liability,* 66 Colum.L.Rev. 1462,

1482-83 (1966). See also *Moscarelli* v. *Stamm*, 288 F.Supp. 453, 458-60 (E.D.N.Y. 1968).

The result below is compelled by numerous decisions in similar circumstances barring recovery under the established doctrines of waiver, estoppel, laches and assumption of risk, which have long been recognized as applicable in civil actions under the securities acts. See *Straley* v. *Universal Uranium and Milling Corp.*, 289 F.2d 370, 373-374 (9th Cir. 1961); *Royal Air Properties, Inc.* v. *Smith*, 312 F.2d 210, 213-214 (9th Cir. 1962) ("The purpose of the Securities Exchange Act is to protect the innocent investor, not one who loses his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act"); *Moscarelli* v. *Stamm, supra; Carr* v. *Warner*, 137 F.Supp. 611 (D.Mass. 1955); *Nash* v. *J. Arthur Warner & Co.*, 137 F.Supp. 615 (D.Mass. 1955); *Goldenberg* v. *Bache & Co.*, 270 F.2d 675, 681 (5th Cir. 1959); *Belhumeur* v. *Dawson*, 229 F.Supp. 78, 86 (D.Mont. 1964) ("The defense of estoppel is available in a Securities Act case"); *Dale* v. *Rosenfeld*, 229 F.2d 855, 859 (2d Cir. 1956) (defenses of waiver and estoppel available in an action under section 12 of the Securities Act of 1933); *DeLamar Mines of Montana* v. *Mackay*, 104 F.2d 271, 274 (9th Cir. 1939). *Restatement, Torts* § 286 (1934), upon which implied civil liability for violation of section 7 of the 1934 Act has been predicated, states that liability arises only if

> "(d) the violation is a legal cause of the invasion, and the other has not so conducted himself as to disable himself from maintaining an action."

Petitioner's conduct goes far beyond that of the plaintiffs in any of the cited cases. Knowing full well the risks involved and the margin requirements he was violating, petitioner chose to assert his claim only when his speculations proved unprofitable. He had refused to protect

himself despite repeated warnings and requests by respondent's officers with respect to his indebtedness. He voluntarily assumed the risk of loss, and he cannot now be heard to complain.

II

The judgment below is in accord with this Court's decision in the *Perma Life Mufflers* case.

Petitioner refers to the decision of this Court in *Perma Life Mufflers, Inc.* v. *International Parts Corporation*, 392 U.S. 134 (1968) and argues (Petition 11-14) that under the authority of that case the Court should grant him recovery to further the public policy of the margin regulations, irrespective of his own conduct. The argument is premised on petitioner's assertions that the duty to comply with the margin requirements was imposed solely on respondent (Petition 11-12, 13-14).

Petitioner is in error in this contention. As a registered representative of the New York Stock Exchange, petitioner was charged by law and by his agreements with the Stock Exchange and his employers with the duty to observe and enforce the margin requirements—Regulation T—which applied to his conduct as a broker. When he procured loans in excess of the margin limitations and speculated with the proceeds, he violated Regulation T.

In a 1953 interpretation of its Regulation T, the Federal Reserve Board said:

> "§ 220.111 Arranging for extensions of credit to be made by a bank.
>
> "(a) The Board has recently had occasion to express opinions regarding the requirements which apply when a person subject to this part (for convenience,

called here simply a broker) arranges for a bank to extend credit.

"(b) The matter is treated generally in § 220.7(a) and is also subject to the general rule of law that any person who aids or abets a violation of law by another is himself guilty of a violation. It may be stated as a general principle that any person who arranges for credit to be extended by someone else has a responsibility so to conduct his activities as not to be a participant in a violation of this part, which applies to brokers, or Part 221 of this subchapter, which applies to banks." (12 C.F.R. 220.111)

Petitioner's violation of Regulation T is clear. In *Remar* v. *Clayton Securities Corp.*, 81 F.Supp. 1014 (D. Mass. 1949), the Court held that defendant, a broker, violated Regulation T by arranging an unlawful bank loan for one of its customers. Petitioner's conduct in this action is far more reprehensible than that of the defendant in *Remar*. Petitioner obtained the loans for his own account by false representations, rather than for a customer. *Matter of Sutro Bros. & Co.*, Securities Exchange Act Release No. 7052 (1963) is directly in point. That case dealt with loans to customers of a brokerage firm by factors, not subject to Regulation T or U. The Commission held that where a broker or registered representative "arranges" a loan from a factor for a customer in excess of the margin requirements, he violates Regulation T. The Commission also held that a registered representative violates Regulation T by obtaining excessive credit from a factor for speculation for his own account.

The principle announced in *Perma Life Mufflers* is inapplicable to the facts in this case. Plaintiffs in that case were dealers who had operated muffler shops under sales agreements with one of the defendants. This Court, in reversing the District Court and the Court of Appeals, de-

cleared that *in pari delicto* is not a defense in treble damage actions under the anti-trust laws.

Plaintiffs in *Perma Life Mufflers* were not *in pari delicto* in the traditional sense, as their participation in the illegal franchises "was not voluntary in any meaningful sense" and they "accepted many of these restraints solely because their acquiescence was necessary to obtain an otherwise attractive business opportunity" (392 U.S. at 139). Thus, the parties were not "of equal fault", nor had the plaintiffs actually "violated the law in cooperation with the defendant" (392 U. S. at 153).

Unlike the plaintiffs in *Perma Life Mufflers,* petitioner is *in pari delicto* in the traditional sense. His conduct was not only a violation of Regulation T, but he induced the making of the loans by false representations and it was his misuse of the proceeds that caused the violation. Respondent granted the loans on the basis of petitioner's misrepresentations and its only wrong was in failing to discover his fraud. Respondent did not actively and knowingly instigate or participate in the violations. The Trial Court found that none of respondent's officers having anything to do with the loans had knowledge of petitioner's fraud. Petitioner was the active wrongdoer. Moreover, while the private treble damage suit was specifically authorized by Congress as a means of enforcement of the anti-trust laws, no such private right of action was enacted by Congress in connection with section 7 of the 1934 Act or the margin regulations. There is nothing to suggest that it was Congress' intention that traditional defenses such as *in pari delicto* should not be applicable in any implied civil liability.

In its opinion, the District Court considered the decision in *Perma Life Mufflers.* Applying the standard prescribed by this Court in *Perma Life Mufflers,* the District Court concluded that the overriding public policy of deterring excessive use of borrowed funds for speculation in the stock market would be advanced by refusing to confer a

windfall on an investor-borrower who obtains loans by false representations in the expectation that "he could keep the profits if his speculation proved profitable and have the lender bear the loss if the speculation proved unprofitable" (290 F.Supp. at 89).

III

The decisions below do not establish any general principle of law meriting review by this Court.

The District Court concluded on the basis of the facts adduced on the trial that the purpose of the law would be subverted by rewarding a party for knowingly violating the law for his own benefit. The decision rests on its particular facts. Determinations as to the impact of particular policies as applied in particular factual situations can be made only on a case-by-case basis.

Conclusion

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

(1)

The Respondent relies heavily on such common law defensive principles as estoppel, waiver and assumption of risk to defeat the Petition. Its reliance, however, is misplaced. Even if it were to be assumed that such defenses would otherwise be valid in the situation at bar, it is submitted that these common law doctrines which have their genesis in litigation and claims involving only adverse parties, have no place where a private suit serves an important public purpose, thus making the general public, in effect, a Third Party Beneficiary. Mr. Justice Black, in discussing the doctrine of *pari delicto* in *Perma Life Mufflers, Inc.* v. *International Parts Corporation*, 392 U. S. 134 (1968) had this to say on that subject, at page 138:

> "We have often indicated the inappropriateness of invoking broad common law barriers to relief where a private suit serves important public purposes."

As shown in Petitioner's main brief, the dominant purpose of the statutory margin provisions is to provide an effective method of reducing the aggregate amount of the nation's credit resources which can be directed by speculation into the stock market and out of the other more desirable uses of commerce and industry. Private suits are its most effective enforcement vehicle, and should not be frustrated by common law defensive principles.

However, even aside from the public policy doctrine enunciated by Mr. Justice Black, wherein the sole test appears to be whether or not a public purpose is served in allowing the suit, the defendant's reliance on these common law defenses would not be well taken.

The defendant urges that the plaintiff is estopped but one of the indispensable elements of estoppel is ignorance of the true facts on the part of the party who invokes the doctrine. There can be no application of the principle where both parties are fully aware of the real situation and it is crystal clear that the Respondent knew the purpose for which the Petitioner borrowed the funds. (See Petitioner's main brief at pages 5 and 6).

Both the District Court and Respondent rely heavily on *Moscarelli* v. *Stamm*, 288 F.Supp. 453 as a parallel case to the one at bar and standing for the proposition that to reward a "wrong-doer" would subvert the policy and purpose of the margin requirements. The facts in the *Moscarelli* case are a far cry from those in the case at bar. *Moscarelli* involved a motion for summary judgment by the plaintiffs against the defendant for, among other things, a violation of Regulation T (comparable to U but applicable to brokers). The defendant's answering affidavits maintained that the plaintiffs had conspired with certain dishonest employees of the defendant to purchase large

quantities of stock without adequate security, and that the defendant was ignorant of the acts of its dishonest employees and the victim of the conspiracy. In that context, the Court denied plaintiffs' motion for summary judgment on the ground that they wilfully participated in the violation of the Regulation. Obviously, to permit recovery in such a situation would encourage dishonest investors to induce dishonest employees to perpetrate violations of the statute and would defeat its purpose. That type of situation cannot be equated with the facts of the case at bar where the alleged participation consisted at worst of a misrepresentation of the purpose of the borrowings.

(2)

The Respondent maintains that the Petitioner is barred under the doctrine of *pari delicto*. It contends that while the Respondent may have been guilty of violating Regulation U, the Petitioner (who was neither a broker or a dealer but a simple securities salesman) was guilty at the same time, of violating Regulation T. In support of that claim, Respondent cites an administrative decision of the Securities Exchange Commission of doubtful logic which was rendered in 1963, some five years after the commencement of the dealing between the plaintiff and the defendant. Even if the claim of the Respondent is accurate and the Petitioner was guilty of violating Regulation T, he would nonetheless not be barred under the common law doctrine of *pari delicto*. *Pari delicto* means equal fault and, it is true that if the parties are equally at fault, unless a public interest is advanced by allowing one to prevail as against the other, the Courts will leave them where they find them. See *Duval* v. *Wellman*, 124 N.Y. 156. However, if the actions of the Petitioner in the instant suit are either more excusable than the actions of the Respondent or if

the public interest will be advanced if the Petitioner is permitted to recover, his suit will not be barred by the *pari delicto* doctrine. It is submitted that on either score, i.e., public interest or on the grounds that he is the more innocent party, the Petitioner is entitled to recover. There is no question but that the suit at bar involves Regulation U and that the sole burden of compliance with Regulation U is on the lender. If that is not enough to tip the scales, then a simple examination of the parties involved and their relative stature and knowledge should be sufficient. On the one hand, we have The Chase Manhattan Bank, undoubtedly, one of the largest financial institutions in the world—knowledgeable to the highest degree—with regard to banking and government regulations pertaining thereto. On the other hand, we have the Petitioner, a Polish immigrant of limited education, who by hint of hard work succeeded in raising himself from a steward on a cargo ship to a customer's man with a Wall Street firm. As a customer's man, his sole function was to sell securities for a commission with only limited experience at the time the loan was made. At this form of work, his income did not exceed $5300 (Exhibit 39). There is of course no equality between the two. In addition the evidence clearly discloses that the bank loans were knowingly made to Petitioner for the express purpose of carrying and purchasing registered securities in excess of their permissible maximum loan value which constituted a violation of Regulation U (Exhibit No. 2 and Exhibit No. 3, 405A).

(3)

The Respondent's brief speaks of errors and omissions in Appendix B of the petition and because of those errors and omissions refers the Court to the District Court's opinion as reported at 290 F. Supp. 74. A careful com-

parison between Appendix B and the printed report in 290 F. Supp. 74 reveals the following errors:

1. Failure to put single quotation marks around the word carrying in the footnote on page 12a and failure to put a quotation mark after the word "stock" at the end of that same footnote.

2. Failure to include the following words, after the word "public" which appears on the tenth line from the top of page 32a, "policy in favor of competition. A more fastidious regard."

Respectfully submitted,

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